

Message Text

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PASS TREASURY, CEA AND FEDERAL RESERVE

E.O. 11652: N/A
TAGS: EFIN, OECD
SUBJECT: INFORMAL MEETING OF EXPERTS OF WORKING PARTY
3 OF EPC SCHEDULED FOR SEPTEMBER 14 - 15

REF: A) PARIS 21904, B) PARIS 20300, C) PARIS 8197

1. SECRETARIAT (FAY) HAS ISSUED CONVOCATION LETTER
AND DOCUMENTS FOR MEETING ON SEPTEMBER 14 - 15 OF
EXPERTS OF WP 3 ON COMPETITIVENESS, EXPORT PRICING
AND TRADE PERFORMANCE. THE DOCUMENTS, WHICH ARE BEING
TRANSMITTED THROUGH THE USUAL DISTRIBUTION CHANNELS,
CONSIST OF AN ANNOTATED AGENDA, CPE/WP3(78)8, A NOTE
ON "COMPETITIVE POSITION, EXPORT PRICING AND TRADE
PERFORMANCE", DES/NI(78)13, AND AN OFF-PRINT OF A
STUDY BY THE SECRETARIAT ENTITLED "THE INTERNATIONAL
COMPETITIVENESS OF SELECTED OECD COUNTRIES". THE
LATTER IS BEING PUBLISHED UNDER THE SECRETARIAT'S
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RESPONSIBILITY AS AN "OCCASIONAL STUDY" ACCOMPANYING
THE OECD'S SEMI-ANNUAL "ECONOMIC OUTLOOK" WHICH IS
BEING RELEASED ON JULY 28. THE FULL
TEXT OF THE ANNOTATED AGENDA DOCUMENT IS REPRODUCED
UNDER PARAGRAPH 3 BELOW.

2. WP 3 EXPERTS MEETING WILL BEGIN AT 10:30 A.M. ON

SEPTEMBER 14. ACTION REQUESTED: PLEASE INFORM
MISSION OF U.S. EXPERT(S) DESIGNATED TO ATTEND THE
MEETING.

3. ANNOTATED AGENDA DOCUMENT CPE/WP3(78)8 READS AS
FOLLOWS:

BEGIN QUOTE

1. TO SERVE AS BACKGROUND MATERIAL FOR THE INFORMAL
MEETING ON 14TH-15TH SEPTEMBER OF EXPERTS DESIGNATED
BY MEMBERS OF WORKING PARTY NO. 3, THE SECRETARIAT
HAS PREPARED A PAPER DES/NI(78)13, WHICH ATTEMPTS TO
ELABORATE THE MOST IMPORTANT POINTS OF RECENT DIS-
CUSSION OF THE CALCULATION AND ANALYTICAL APPLICATION OF
MEASURES OF COMPETITIVE POSITION. IN ADDITION, SOME
FURTHER WORK BY THE SECRETARIAT IS PRESENTED. THE
PRESENT NOTE SUMMARISES, IN THE FORM OF AN ANNOTATED
AGENDA, THE MAIN CONCLUSIONS AND ISSUES FOR DISCUSSION
BROUGHT OUT IN THE LONGER PAPER. THE BROAD TOPICS
COVERED ARE THE FURTHER REFINEMENT OF SECRETARIAT
MEASURES OF COMPETITIVE POSITION, THE USE OF COMPETITIVE
POSITION INDICATORS IN THE ANALYSIS OF EXCHANGE RATES,
THE RELATIONSHIP BETWEEN COMPETITIVE POSITION, EXPORT
PRICING AND EXPORT PROFIT MARGINS, AND THE EFFECT OF
CHANGES IN COMPETITIVE POSITION ON TRADE PERFORMANCE
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(IMPORT AND EXPORT VOLUMES). AT THE MEETING NATIONAL
EXPERTS MAY, OF COURSE, WISH TO ADD FURTHER ITEMS TO
THE PROPOSED AGENDA. IN COMMENTING ON THE SECRETARIAT'S
EMPIRICAL WORK, IT WOULD BE USEFUL IF EXPERTS WERE
IN A POSITION TO MAKE AVAILABLE SIMILAR WORK DONE IN
CAPITALS - IN PARTICULAR IN CASES OF DISAGREEMENT WITH
SECRETARIAT RESULTS OR CONCLUSIONS. MEMBERS OF THE
SECRETARIAT WILL ALSO BE AVAILABLE FOR BILATERAL
CONSULTATIONS ALONGSIDE THE MEETING.

FURTHER REFINEMENT OF CALCULATIONS OF COMPETITIVENESS

2. WOULD THE EXPERTS AGREE THAT, IN CONSIDERING POSSIBLE
FURTHER REFINEMENTS OF THE SECRETARIAT MEASURES OF
COMPETITIVE POSITION, IT IS IMPORTANT NOT TO LOSE SIGHT
OF THE DESIRABILITY OF RETAINING THE RELATIVELY CLEAR
INTERNATIONAL COMPARABILITY AND TRANSPARENCY OF THE
PRESENT INDICATORS, AND THAT THE LEVEL OF SOPHISTICATION
OF THE INDICATORS SHOULD NOT BE PUSHED BEYOND THAT
OF POSSIBLE APPLICATIONS? IF SO, HOW MUCH SCOPE IS
THERE FOR SUCH IMPROVEMENTS AS: MORE CAREFUL CALCULATION
OF RELATIVE WEIGHTS OF LABOUR AND MATERIALS COSTS IN THE

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"TOTAL UNIT COSTS" INDICATOR; USE OF VARIABLE WEIGHTS;
USE OF MATERIALS COSTS DRAWN FROM A WIDER BODY OF
NATIONAL SOURCES; INCLUSION OF CAPITAL COSTS; AND
SECTORAL DISAGGREGATION? IF, AS HAS BEEN SUGGESTED,
INDICATORS OF COMPETITIVE POSITION ARE BASED ON
"TRENDED PRODUCTIVITY" UNIT COSTS (FOOTNOTE 1), EXPERTS
MAY WISH TO EXCHANGE VIEWS ON HOW BEST TO SITUATE THE
TREND IN THE MOST RECENT PERIOD.

EXCHANGE RATES

3. RECENTLY, CHANGES IN COMPETITIVE POSITION HAVE
INCREASINGLY BEEN DESCRIBED AS CHANGES IN THE "REAL"
EXCHANGE RATE. AT THE SAME TIME, IT HAS BEEN ARGUED
THAT CONSIDERABLE CARE MUST BE TAKEN IN COMPARING
FREQUENTLY-OFFSETTING CHANGES IN COMPETITIVE POSITION
IN LOCAL CURRENCY TERMS (I.E. UNADJUSTED FOR EXCHANGE
RATE CHANGES) WITH CHANGES IN EXCHANGE RATES. HERE IT
IS POINTED OUT THAT EXCHANGE RATES ARE AFFECTED BY A
WIDER RANGE OF FACTORS THAN IMPLIED IN A "PURCHASING
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POWER PARITY" VIEW OF EXCHANGE RATE DETERMINATION. TO CLARIFY THE DISCUSSION OF THESE POINTS, EXPERTS MAY WISH TO EXCHANGE VIEWS ON THE PRECISE MEANING WHICH SHOULD ATTACH TO THE TERM " 'REAL' EXCHANGE RATES" AND TO DISTINGUISH BETWEEN AREAS IN WHICH THIS IS OR IS NOT AN APPROPRIATE TOOL OF ECONOMIC ANALYSIS.

4. HAVING DEFINED WITH SOME CARE THE CONCEPT OF A "REAL" EXCHANGE RATE CHANGE, EXPERTS MAY FIND IT USEFUL TO GO ON TO CONSIDER CONDITIONS UNDER WHICH SUCH A CHANGE IS MORE OR LESS LIKELY TO "STICK". IN THIS CONNECTION, IT HAS BEEN OBSERVED THAT, DURING THE PERIOD OF GENERALISED FLOATING, "REAL" EXCHANGE RATES (AS MEASURED BY VARIOUS INDICATORS OF COMPETITIVE POSITION) HAVE NOT CHANGED SUBSTANTIALLY FOR MOST EUROPEAN COUNTRIES - DESPITE LARGE NOMINAL EXCHANGE RATE CHANGES IN SOME CASES - WHILE THERE IS REASON TO BELIEVE THAT THE RECENT SIGNIFICANT "REAL" EXCHANGE RATE CHANGES OF BOTH THE UNITED STATES AND JAPAN MAY BE BETTER SUSTAINED. HERE EXPERTS WILL WISH TO EXCHANGE VIEWS ON HOW COMPREHENSIVE AN ANALYSIS OF THE RELATIONSHIP BETWEEN DOMESTIC COSTS/PRICES AND EXCHANGE RATES IS REQUIRED TO TREAT THIS QUESTION ADEQUATELY (FOOTNOTE 2). IN PARTICULAR, EXPERT COMMENT WOULD BE USEFUL ON HOW FAR THE SUSTAINABILITY OF "REAL" EXCHANGE RATE CHANGES DEPENDS ON INSTITUTIONAL FACTORS (SUCH AS WAGE-BARGAINING ARRANGEMENTS), STRUCTURAL FEATURES (SUCH AS THE DEGREE OF OPENNESS OF THE ECONOMY), OR THE POLICY STANCE.

5. ON THE SUBJECT OF EXCHANGE RATES MORE GENERALLY, EXPERTS MAY FIND IT PROFITABLE TO EXCHANGE VIEWS ON WHAT SORT OF EMPIRICAL WORK ON EXCHANGE RATE LIMITED OFFICIAL USE

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DETERMINATION IS MOST LIKELY, IN PRACTICAL TERMS, TO BE USEFUL TO APPLIED POLICY ANALYSIS IN THIS AREA.

EXPORT PRICING

6. IN EARLIER WORK, THE SECRETARIAT HAD SUGGESTED THAT THE TRADITIONAL CLASSIFICATION OF THE PRICING BEHAVIOUR OF EXPORTING COUNTRIES INTO "PRICE SETTING" OR "PRICE TAKING" WAS SIMPLISTIC AND UNHELPFUL; EXPORT PRICING BEHAVIOUR IS LIKELY TO VARY OVER TIME DEPENDING INTER ALIA ON COMPETITIVE POSITION, PROFITS, AND EXCHANGE RATES. THE EXPERTS MAY WISH TO EXCHANGE

VIEWS ON THE LIKELY PRICING BEHAVIOUR OF EXPORTERS FACED WITH INCREASES OR DECREASES OF DOMESTIC COSTS, FOREIGN COMPETITORS' PRICES OR EXCHANGE RATES. EXPERTS MAY WISH TO TAKE AS A STARTING POINT FOR THIS ITEM OF DISCUSSION THE THEORETICAL SUGGESTIONS PUT FORWARD BY THE SECRETARIAT IN PARAGRAPH 4 OF DES/NI(78)13, IN PARTICULAR THE SUGGESTION THAT IN PRACTICAL TERMS EXPORTERS MAY BE FACING A DEMAND GROWTH OF VARYING ELASTICITY WHICH, TO SOME EXTENT, CONDITIONS THEIR EXPORT PRICING BEHAVIOUR.

7. THE EXPERTS WILL ALSO WISH TO COMMENT ON THE BODY OF EVIDENCE PRESENTED BY THE SECRETARIAT TO THE EFFECT THAT CHANGES IN RELATIVE COSTS BEYOND A CERTAIN THRESHOLD CAN, IN MANY CASES, BE EXPECTED TO GIVE RISE TO OFFSETTING MOVEMENTS IN EXPORT PROFITS. IN CONNECTION WITH THIS EMPIRICAL EVIDENCE, EXPERTS MAY WISH TO COMMENT ON THE TECHNIQUE USED BY THE SECRETARIAT TO OBTAIN A BROAD APPROXIMATION TO EXPORT PROFITS.

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8. THE SECRETARIAT HAS ALSO RUN SOME REGRESSIONS RELATING EXPORT PRICES TO HOME COSTS AND FOREIGN PRICES IN A LAG-ADJUSTED SPECIFICATION. THE REGRESSIONS WERE RUN OVER DIFFERENT TIME PERIODS TO TEST FOR

STRUCTURAL CHANGE. THE RESULTS OBTAINED, WHICH WERE TOO UNEVEN TO BE CONCLUSIVE, ARE PRESENTED IN ANNEX B OF DES/NI(78)13. EXPERTS MAY WISH TO COMMENT BRIEFLY ON THE RESULTS FOR THEIR COUNTRY.

TRADE PERFORMANCE

9. THE SECRETARIAT HAS ALSO ESTIMATED REGRESSIONS FOR IMPORT AND EXPORT VOLUMES OF MANUFACTURED GOODS. ALTHOUGH THIS REPRESENTS A FIRST STEP IN THE UPDATING AND RE-ESTIMATION OF THE SECRETARIAT WORLD TRADE MODEL, EFFORT AT THIS STAGE WAS FOCUSED ON DETERMINING THE BEST INDICATOR OF COMPETITIVE POSITION TO INCLUDE IN THE SPECIFICATIONS BEING ESTIMATED. IN THIS CONNECTION, THE SECRETARIAT HAS ARGUED PREVIOUSLY THAT, IN LIMITED OFFICIAL USE

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THEORY, RELATIVE COSTS WERE MORE COMPREHENSIVE THAN RELATIVE PRICES AND MIGHT THEREFORE BE EXPECTED TO PERFORM BETTER AS AN EXPLANATORY VARIABLE. IN PRACTICE, THERE WAS SOME EVIDENCE TO THIS EFFECT IN THE REGRESSIONS ESTIMATED, THOUGH THESE CAN ONLY BE CONSIDERED PRELIMINARY. EXPERTS WILL WISH TO COMMENT ON THESE RESULTS (PRESENTED IN PART V OF DES/NI(78)L3).

10. MORE GENERALLY, EXPERTS MAY WISH TO EXCHANGE VIEWS ON THE QUESTION OF WHETHER, WITHIN THE LIMITATIONS OF PRESENT ECONOMETRIC TECHNIQUE AND EXISTING DATA, IT IS POSSIBLE TO ESTIMATE SATISFACTORILY THE SIZE AND TIME-LAG OF THE EFFECT OF CHANGES IN COMPETITIVE POSITION ON TRADE FLOWS. (FOOTNOTE 3) IF NOT, WHAT VIEWS DO EXPERTS TAKE ON THE ALTERNATIVE APPROACH OF SPECIFYING A PRIORI AN ELASTICITY AND LAG STRUCTURE WHEN ATTEMPTING TO ASSESS THE EXTENT TO WHICH A SHIFT IN COMPETITIVE POSITION MAY AFFECT A COUNTRY'S TRADE BALANCE?

FOOTNOTES:

(1) THE SECRETARIAT INDICATORS HAVE BEEN BASED ON A FOUR-QUARTER MOVING AVERAGE OF UNIT COSTS. A NOTE COMPARING THESE MEASURES WITH THOSE BASED ON "TRENDED PRODUCTIVITY" UNIT COSTS WILL BE CIRCULATED SHORTLY BEFORE THE EXPERTS' MEETING.

(2) SECRETARIAT TREATMENT OF THIS QUESTION IN PREVIOUS NOTES FOR WORKING PARTY NO. 3 HAS BEEN CRITICISED IN SOME QUARTERS AS BEING TOO LIMITED.

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(3) THE SECRETARIAT IS FAR FROM CONFIDENT ABOUT THE ROBUSTNESS OF CERTAIN OF ITS ESTIMATES OF THE ELASTICITIES OF TRADE PERFORMANCE WITH RESPECT TO COMPETITIVE POSITION; IN A NUMBER OF CASES, COLLINEARITY APPEARS TO BE AFFECTING THE RESULTS OBTAINED. FURTHERMORE, IN CERTAIN OF THE IMPORT EQUATIONS, THE COEFFICIENT OF COMPETITIVE POSITION HAS THE WRONG SIGN.

END QUOTE
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